The Southland Corporation Annual Report -- 1968
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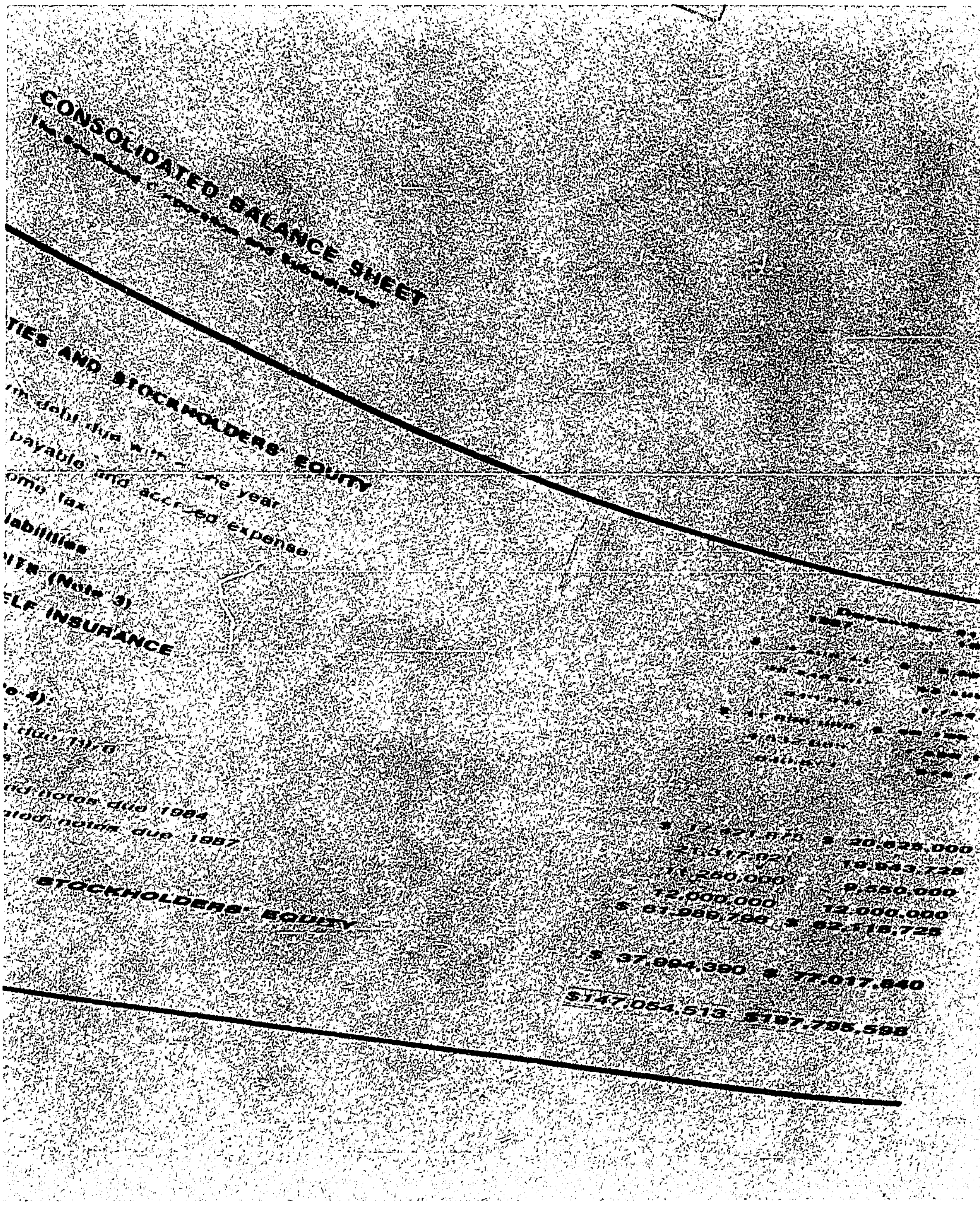
THE SOUTHLAND CORPORATION 1968 ANNUAL REPORT



THE SOUTHLAND CORPORATION
1968 ANNUAL REPORT

Corporate Data

Transfer Agents:
First National Bank in Dallas, Dallas, Texas
The Chase Manhattan Bank, N.A., New York City

Registrars:
Texas Bank & Trust Company of Dallas, Dallas, Texas
First National City Bank, New York City

Common Stock Traded
Over-the-Counter

Annual Meeting:
10 a.m., April 23, 1969, Dallas Room
First National Bank in Dallas

Mailing Address:
P. O. Box 719, Dallas, Texas 75221

Telephone:
214-821-8121

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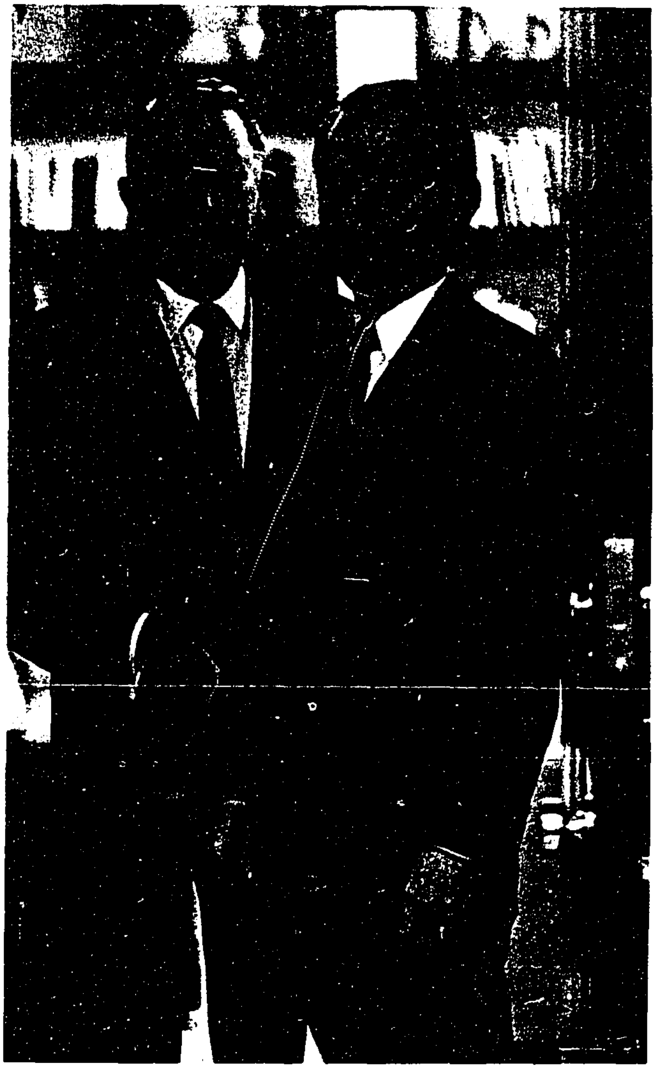
FINANCIAL HIGHLIGHTS

FOR THE YEAR	Year ended December 31 1967	1968
Total Revenues	$527,487,890	**$622,044,058**
Earnings Before Extraordinary Item	$ 7,214,033	**$ 9,345,797**
Extraordinary Item	520,000	—
Net Earnings	$ 7,734,033	**$ 9,345,797**
Per Share*		
Earnings Before Extraordinary Item	1.22	**1.40**
Extraordinary Item	.09	—
Net Earnings	1.31	**1.40**
Cash Dividends	$ 1,342,085	**$ 1,557,096**
AT YEAR-END		
Net Working Capital	$ 41,056,359	**$ 56,629,452**
Current Ratio	1.98 to 1	**2.13 to 1**
Long-Term Debt	$ 61,989,796	**$ 62,118,725**
Stockholders' Equity	$ 37,994,390	**$ 77,017,840**
Average Shares Outstanding	5,885,470	**6,653,451**
Book Value Per Share*	6.46	**11.58**
Number of Stockholders	2,816	**7,457**
Number of Employees	13,900	**16,900**
Annual Dividend Rate Per Share	.24	**.24**

****Based on average number of shares outstanding during the period.***

TO OUR STOCKHOLDERS AND EMPLOYEES:



The past year was one of the more successful in Southland's long history, reflecting the cumulative results of 41 years of effort. It was a period of internal growth that, in many respects, was the greatest in our history. It was a year, too, in which several significant events occurred.

Briefly, in 1968 Southland . . .

- Increased net operating earnings by 29.6% and total revenues by 17.9% over 1967.
- Opened a record 471 new stores.
- Raised $17,437,500 through the sale of common stock, and increased the number of stockholders from 2,816 to 7,457.
- Acquired the 115 stores of Gristede Bros., Inc., the largest and best-known prestige grocery chain in the Greater New York City area.

- Entered the New England market with the acquisition of a chain of convenience food stores in the Boston area.
- Air conditioned and remodeled 623 older stores in a modernization program that is designed to encompass all stores by 1970.
- Granted the first area franchise for operation of 7-Eleven stores.
- Expanded dairy facilities and immediately after year-end acquired the Sidney Wanzer & Sons, Inc. dairy of Chicago.
- Announced it expects to enter into an agreement to acquire the toiletries and cosmetics operations of The Nestle-LeMur Company, subject to approval by stockholders of both companies.

In line with our sales and profit objectives for the year, total revenues were at a record high of $622,044,058, up 17.9% over last year's $527,487,890. Internal expansion in all areas of our operations contributed to this excellent increase. During the year 471 new stores were opened, the largest number in any one year in the Company's history. In addition, through improved marketing, merchandising and advertising programs, the average sales volume in our older stores was again increased and we were also able to produce increased sales of dairy products at better profit margins.

Net earnings from operations were $9,345,797, an increase of 29.6% over 1967 earnings of $7,214,033. Based on 6,653,451 shares, the average number outstanding during the year, adjusted for all stock dividends and reflecting the additional new shares outstanding as a result of the common stock offering in April, earnings from operations rose to $1.40 a share from $1.22 a share in 1967 and 96 cents a share two years ago.

Cash dividends paid during the year amounted to $1,557,096 compared to $1,342,085 for 1967. Also, as reported in last year's Annual Report, the Board of Directors declared a three-for-two stock split to stockholders of record January 31, 1968, and in addition, a 3% stock dividend was paid in November, 1968.

To help finance its expansion for the year, the Company on April 5. 1968 made a public offering of 750,000 shares of its common stock. The proceeds of $17,437,500 enabled the Company to accelerate its store building program, to remodel and air condition 623 of its older stores and to expand and modernize its dairies, ice and chemical facilities. To provide the necessary funds for

further growth, the Company on February 20, 1969 filed a registration statement covering a proposed offering to the public of $40 million in Convertible Subordinated Debentures.

During the year members of Southland's management team presented the Southland story to security analyst groups in New York City, Washington, D. C., Jacksonville and Philadelphia, and similar appearances are scheduled for 1969. These opportunities, along with articles in financial and business publications, serve to inform increasing numbers of people about Southland and its potential in our segment of the food distribution industry.

Of significance was the acquisition in December of Gristede Bros., Inc. of New York City. The merger of this respected chain of 115 stores provides Southland with its first entry into the New York City metropolitan market. Those of you who are familiar with this area undoubtedly are aware of Gristede's excellent reputation for meats, groceries and produce. It will be the seventh of our Store Divisions and will be operated under the established Gristede name with the same long-experienced management and store personnel.

Immediately after the end of the year Southland acquired the 111-year-old Sidney Wanzer & Sons, Inc. dairy in Chicago in an exchange of stock. Wanzer has an excellent reputation for quality milk and dairy products which are sold to institutions, grocery stores and at retail through distributors. Wanzer milk is considered the largest selling milk in Chicago, and in 1968 the company processed 267 million pounds of milk. Wanzer will operate under its present management as the ninth of our Dairy Divisions. This acquisition enables Southland to serve another great and growing metropolitan area of our country with its quality dairy products.

The Company expects to enter into an agreement to acquire the toiletries and cosmetics operations of The Nestle-LeMur Company. We anticipate our stockholders will vote on the proposal at a special meeting to be held later this year.

Southland searches for the best management methods available to achieve internal growth and increase sales and profits in our already established outlets. Management has developed many new merchandising plans which it believes will appeal to all of its customers, and has designed and installed new programs to control expenses and improve productivity. Outstanding among these are modernized management information systems in the Dairy and Store Divisions to assist them in such vital areas as distribution, cost accounting, financial reporting, site selection and product movement and profitability.

Genuine friendliness, convenience and a sincere interest in the shopper are the keys to keeping our old customers and gaining new ones. Merchandising skills which sufficed only a few years ago are no longer adequate, and we constantly strive to improve our product lines, merchandising techniques and customer services.

We are confident Southland is entering a period of great growth potential. The same spirit of innovation and aggressiveness that has guided our expansion during the past years will enable us to grow and increase our position in the merchandising field. Our employees are alert to this fact, and it is with deep appreciation that we recognize their dedicated efforts, as well as the fine support shown by our customers, suppliers and stockholders.

We firmly believe that our philosophy of business developed over 41 years, the consumer's increasing demand for greater convenience and the continued growth in population, form the basis for optimism in 1969 and the years to come.

In the pages which follow you will read about our operations throughout the country and about our people — without whom our achievements would not be possible.

Very truly yours,

John P. Thompson

John P. Thompson, *President*

H. E. Hartfelder

H. E. Hartfelder, *Executive Vice President*

10 YEARS OF GROWTH
The Southland Corporation and Subsidiaries

NOTES:

(1) Includes The Southland Corporation and subsidiaries. Data for businesses acquired under the pooling of interests concept have been included for years prior to their acquisition by The Southland Corporation.

(2) Net earnings include special items of $449,000 (addition) in 1959, $393,000 (deduction) in 1961 and $520,000 (addition) in 1967.

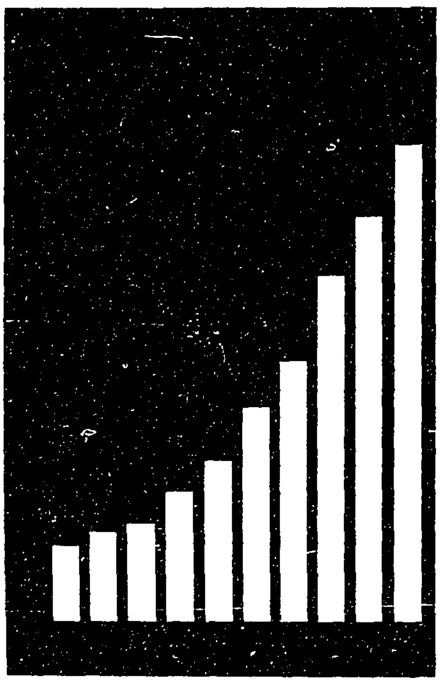
(3) Calculations of per share information are based upon the average number of shares outstanding during the respective years after giving effect to subsequent stock dividends, stock splits and shares issued in exchange for businesses acquired under the pooling of interests concept.

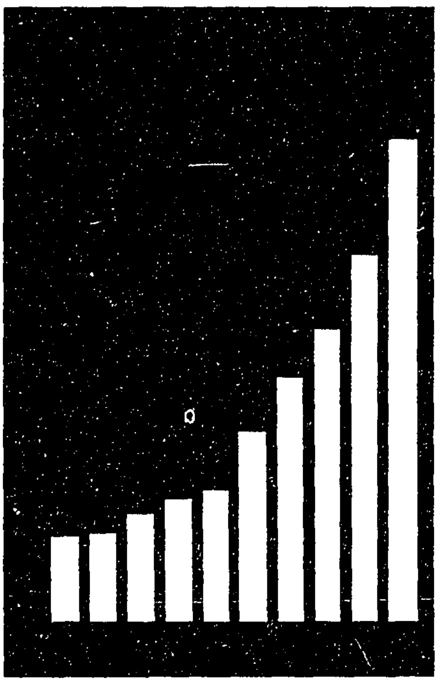
(4) Cash dividends and number of stockholders relate to the parent company only.

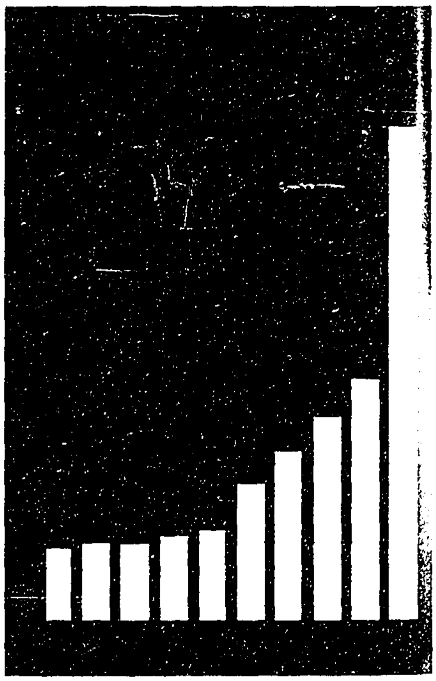
	1959	1960
Total Revenues*	$ 97,635	$ 114,360
Net Earnings (Note 2)*	2,021	1,586
Net Working Capital*	4,681	5,970
Property, Plant & Equipment (Net)*	11,121	11,251
Long-Term Debt*	4,938	5,178
Stockholders' Equity*	10,936	12,000
Cash Dividends (Note 4)	310,966	376,469
Average Shares Outstanding (Note 3)	5,257,590	5,267,232
Number of Stockholders (Note 4)	300	317

*(000 Omitted)

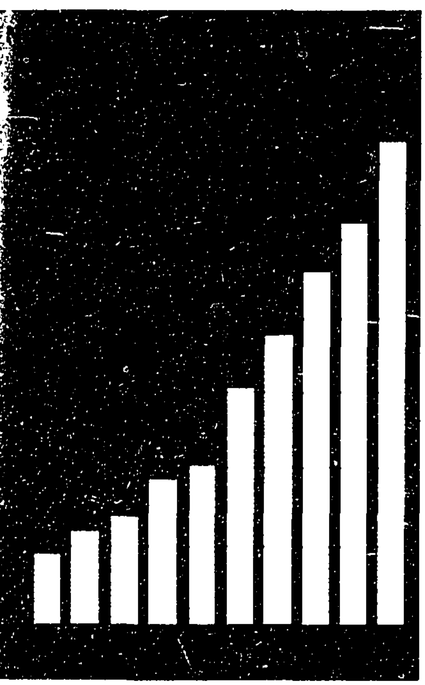
Per Share of Common Stock (Note 3):		
Net Earnings	.38	.30
Cash Dividends (Note 4)	.06	.07
Book Value	2.08	2.28
Earnings as a percent of Stockholders' Equity	18.48	13.22

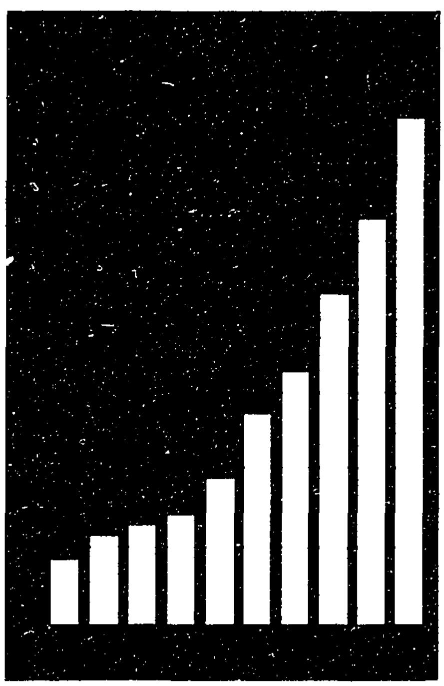


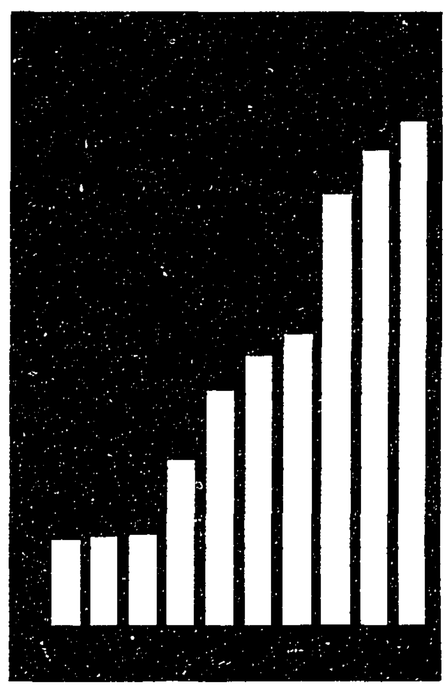




1961	1962	1963	1964	1965	1966	1967	1968
$ 127,511	$ 164,762	$ 209,912	$ 282,535	$ 342,633	$ 450,076	$ 527,488	**$ 622,044**
1,464	2,034	2,563	3,694	4,690	5,632	7,734	**9,346**
5,283	4,799	8,615	28,496	33,020	41,248	41,056	**56,629**
11,902	14,986	20,387	22,333	24,109	43,534	63,374	**90,331**
5,728	6,118	12,787	30,163	30,122	51,382	61,990	**62,119**
11,926	14,070	16,294	20,507	26,171	30,776	37,994	**77,018**
396,786	764,921	888,112	1,081,113	1,105,768	1,249,592	1,342,085	**1,557,096**
5,272,567	5,372,973	5,481,388	5,592,614	5,739,024	5,838,918	5,885,470	**6,653,451**
329	376	514	980	1,228	2,111	2,816	**7,457**
.28	.38	.47	.66	.82	.96	1.31	**1.40**
.08	.14	.16	.19	.19	.21	.23	**.23**
2.26	2.62	2.97	3.67	4.56	5.27	6.46	**11.58**
12.28	14.46	15.73	18.02	17.92	18.30	20.36	**12.13**







STORE OPERATIONS

Operating profits of our Store Divisions in 1968 were 28% higher on a 23% increase in sales as merchandising programs and operational improvements helped raise average store sales and profits. While new stores contributed to the gains, their real impact on sales and profits will be reflected after they are well-established in their communities.

Southland had a net gain of 471 stores during the year which brought the total at year-end to 3,076. This does not include the 115 Gristede stores acquired in December. The 3,000th 7-Eleven Store was opened in November in Deltona, Florida, two and a half years after the 2,000th store was opened in 1966. It is interesting to note that 36 years elapsed between the opening of our first store in 1927 to the opening of the 1,000th 7-Eleven Store in 1963. Present plans call for an additional thousand stores by the end of 1970.

On a state-by-state basis the largest number of stores was opened in California. Although we now have a great number of stores on the West Coast, the potential market for additional stores there remains tremendous.

The purchase of 14 stores in suburban Boston marked our entry into the New England market. Further expansion is planned for that area.

The first three 7-Eleven stores opened in Detroit and present plans are to open approximately 30 additional units in the near future.

At year end 889 stores were operated by independent franchisees. Franchised stores are located in California, Washington, New York, Arizona, Illinois, Nevada, Oregon, New Jersey, Massachusetts, the District of Columbia, Maryland and Michigan, and 67 stores in Texas, Florida and Pennsylvania are being converted to franchise operations at this time. Franchising offers certain advantages to the Company and it is anticipated that it will play an increasingly important role in the Company's store program.

Southland granted its first area franchise in the fall of 1968 for central and northern Michigan with the first units to be opened in Saginaw this spring. In January, 1969, the second area franchise was granted for southern Pennsylvania and northwestern West Virginia with the first units to be opened in Pittsburgh this summer.

Southland's merchandising effort encompasses the entire range of buying, selling, advertising and special promotions and it actively involves everyone from store personnel through the various supervisory levels to division and corporate management. Intensive, formalized attention to this important phase of our business is only a few years old, and during 1968 was expanded at the division level so that we now have a merchandising manager for each of the store divisions. Considerable autonomy is given the divisions, who are in close touch with regional preferences, and they are encouraged to use their initiative in developing profitable activities and products.

Sales of "ICEE" and "SLURPEE" continue to increase and again in 1968 more than 150 million cups were sold.

For some years, in various parts of the country, 7-Eleven stores have sold products under our own labels. One of the new products introduced during 1968 was our own 7-Eleven brand of canned soft drinks. In handsomely-designed, colorful pop-top cans, the drinks were an immediate success. Also, late in 1968 we introduced 7-Eleven brand beer in our Eastern and Southern Store Divisions. We plan to expand the number of products carrying our labels, but we intend to do so only with those items and in those areas where we can improve sales or profits.

To improve the exterior appearance of 7-Eleven stores and experiment with interior decor, inventory arrangement, refrigeration and other physical components, three strikingly different prototype stores were built in Wilmington, Delaware. These incorporate many new ideas, and after careful study and evaluation, the best and most practical will be adopted in future 7-Eleven store concept and design.

In order to keep abreast of the times and our customers' wishes, the Company started in 1968 an extensive program to modernize and air condition its older stores, and our plans for 1969 call for this program to continue. Where required by climate conditions our new stores are being air conditioned as they are built.

For many years, Southland has recognized the importance of employee training. In ten training centers, store employees are instructed in retail selling, product display, customer relations and other related aspects of store operations. In addition to classroom studies, employees receive on-the-job training in a completely

equipped and stocked 7-Eleven store. Similar training courses are designed and conducted in all areas for employees of our dairies.

Specially designed training courses, on the operation of a convenience store, are provided for all new franchise owners before they open their own store.

Southland's "Profit Maker Training Program," initiated about two years ago for our store and dairy supervisory personnel, now has a permanent home in a newly equipped Training Center in Dallas. The Training Center, which was opened in the fall of 1968, is an important forward step in Southland's long-range *planning to provide courses of study and proper* facilities "custom made" to the specific needs and requirements of store and dairy supervisory and management personnel.

During 1969, these courses of study will be extended for the advanced training of district and branch managers, zone managers and other management personnel of our stores and dairies.

Palmer Washen, franchise director [illegible] and [illegible] director of merchandising (right) work closely [illegible] W. Thompson, vice president of store operations, [illegible] programs to further the growth of 7-Eleven stores.

M T. Cochran, Jr, vice president of dairy operations, (center), John Kellum director of purchasing, (left) and Charles Capri, dairy operations sales manager, are surrounded by milk and ice cream packages as they plan new sales and operating strategies

DAIRY OPERATIONS

Operating profits of our Dairy Divisions in 1968 were 35% higher on a 5% increase in sales as a result of significant improvement in market conditions and greatly improved operating efficiencies in our processing and distribution centers.

Plant modernization, rearrangement and consolidation, and the installation of automated materials handling equipment in recent years, all contributed to reduce operating costs, which, in turn, had, and should continue to have, a direct impact on earnings. During the year extensive alterations were made to milk and ice cream plants at Houston and McKinney, Texas; Baltimore, Maryland; Memphis, Tennessee, and Ruston, Louisiana.

A major project, started in late 1968 and to be completed in the second quarter of 1969, is the new milk

processing plant in Orange County, California, which will have the capacity to process in excess of 100,000 gallons of milk a day. Improvements are scheduled for several other plants during 1969.

In the spring the Dairy Divisions introduced complete new packaging designs for ice cream, mellorine and ice milk as companions to the milk and other dairy products packaging which was introduced in 1967. Consumer acceptance of the new designs continues to be excellent.

Our intensified merchandising and promotional programs contributed to the better sales and profits picture. One of the most successful dairy products tie-in promotional program was with various professional football teams throughout the country.

In 1968 a corporate Research and Development Laboratory was established in Dallas to serve all operations of Southland. The laboratory is staffed with expert technical personnel who will seek to create new products which can be profitably merchandised by all divisions. Included in the laboratory is a completely equipped, small-scale pilot milk and ice cream plant and cold storage vault in which actual production conditions can be simulated.

The dairies central laboratory was further expanded to assist each dairy division's own laboratory in their daily quality control activities and to assure our customers the highest quality dairy products from all plants.

For the coming year, Southland Dairy Divisions anticipate increased customer identification and acceptance of their products, and with proven merchandising techniques and programs, more efficient production methods and stable market conditions, a further improvement in earnings.

The acquisition on January 2, 1969 of Sidney Wanzer & Sons, Inc. will be an important addition to Southland's Dairy Operations and brings to the Company an entirely new area for dairy product distribution— the vast Chicago metropolitan market. Wanzer, which was founded in 1857, processes a full line of quality milk and dairy products, and enjoys an excellent reputation in the Chicago market. Many of its customers say it has truly earned its slogan — "Wanzer on Milk is Like Sterling on Silver".

It will be operated by the same fine management under the Wanzer name. Its recently modernized plant is among the finest in the industry, and we are proud to welcome the organization as a part of the Southland family.

Specialty Division

In 1968 Southland formed the Specialty Division to better serve our dairy operations. This division manufactures blow-molded gallon and half-gallon plastic jugs for milk and fruit juice, and provides our dairies with a wide range of novelty supplies such as bags, sticks and flavors for popsicles and ice cream bars.

The division also has developed FUN PAK, a new six-pack of 8-ounce blow-molded plastic bottles of fruit drinks in various flavors. This new product is scheduled for introduction in the Dallas market early in 1969.

FUN PAK is a new fruit drink in 8-ounce plastic bottles which the Specialty Division is introducing in the Dallas market Ches Cochran is manager of the division

Chemical Division

Progress was again the word to describe the Chemical Division activities and accomplishments in 1968. Sales and earnings, though still a very small part of Southland's total, posted substantial gains. More than half the division's sales are to customers other than the Company's Store and Dairy Divisions.

During the year the Chemical Division purchased a small company which specializes in adhesives, coatings and end-seal compounds for the canning industry, and in June it invested in a company located in Monterrey, Mexico, which makes and distributes adhesives, cleaning compounds, conveyor lubricants, insecticides and food stabilizers in that country. During 1969 that company expects to expand into flavors and other products.

In its new facilities in Dallas, enlarged manufacturing, warehouse, offices and laboratories are brought together in a single efficient operation which will allow for growth and expansion.

The Chemical Division's laboratory is devoted to quality control of canned soft drinks and "SLURPEE" flavors and to the development of new flavors for these products. Its laboratory also develops and tests aromatics, colorings and other products, not only for Southland, but also for other dairies, bakeries, canners and other food industry firms.

ICE OPERATIONS

Sales of our ice operations were higher in 1968; however, the increase was limited by plant capacity to produce packaged ice. Late in 1968, the Houston ice vault capacity was doubled and production was stepped up with new automatic ice making equipment.

This year the Dallas plant capacity will be increased by 40 tons of processed ice a day to meet the steadily growing demand in that market.

The building of a new ice-making facility to serve southern Florida was delayed by construction problems. The plant is now open and has a daily capacity of 50 tons of packaged ice, which can be expanded to meet the demand for "REDDY ICE" in that market.

1. Ronald Goodnight, manager of the Chemical Division, directed the division's move into expanded quarters in Dallas. It includes a corporate research and development laboratory, a dairy quality control laboratory and laboratories for the Chemical Division.

2. Paul Reed, manager of Southland's ice operations, inspects an ice vault that stores thousands of bags of crushed and cubed REDDY ICE.

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CONSOLIDATED BALANCE SHEET
The Southland Corporation and Subsidiaries

ASSETS

	December 31 1967	December 31 1968
CURRENT ASSETS:		
Cash	$ 22,842,581	$ 19,340,309
Cash investments	—	4,995,493
Accounts and notes receivable:		
Trade	$ 12,398,322	$ 16,293,375
Franchisee	7,438,116	9,606,725
Other	1,172,152	1,279,623
	$ 21,008,590	$ 27,179,723
Less allowance for doubtful accounts	692,893	1,005,369
	$ 20,315,697	$ 26,174,354
Inventories, at the lower of cost or market:		
Merchandise	$ 24,288,855	$ 31,924,220
Supplies	1,405,643	1,646,227
	$ 25,694,498	$ 33,570,447
Deposits and prepaid expense	4,087,522	5,659,820
Investment in property (Note 2)	10,013,049	17,085,192
Total Current Assets	$ 82,953,347	$106,825,615
INVESTMENTS AND OTHER ASSETS	727,325	638,780
PROPERTY, PLANT AND EQUIPMENT, at cost (Note 4):		
Land	$ 10,438,694	$ 13,119,504
Buildings and leaseholds	31,442,982	36,857,791
Machinery and equipment	38,849,402	57,962,529
Vehicles	1,964,240	2,350,873
Construction in process	1,996,304	6,972,069
	$ 84,691,622	$117,262,766
Less accumulated depreciation	21,317,781	26,931,563
	$ 63,373,841	$ 90,331,203
	$147,054,513	$197,795,598

See notes to financial statements.

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31 1967	December 31 1968
CURRENT LIABILITIES:		
Long-term debt due within one year	$ 4,409,437	**$ 5,361,566**
Accounts payable and accrued expense	36,546,607	**43,109,938**
Federal income tax	940,944	**1,724,659**
Total Current Liabilities	$ 41,896,988	**$ 50,196,163**
DEFERRED CREDITS (Note 3)	4,532,665	**7,586,160**
RESERVES FOR SELF INSURANCE	640,674	**876,710**
LONG-TERM DEBT (Note 4):		
5¾% Promissory notes due 1976	$ 17,421,875	**$ 20,625,000**
4%-7% Real estate notes	21,317,921	**19,943,725**
5% Convertible subordinated notes due 1984	11,250,000	**9,550,000**
5¾% Convertible subordinated notes due 1987	12,000,000	**12,000,000**
	$ 61,989,796	**$ 62,118,725**
STOCKHOLDERS' EQUITY (Notes 4 and 5):		
Common stock, $.01 par value, authorized 20,000,000 shares, issued and *outstanding 7,180,405 shares in 1968, and 5,776,514 shares in 1967*	$ 57,765	**$ 71,804**
Additional paid-in capital	16,894,723	**56,013,638**
Earnings retained in the business	21,041,902	**20,932,398**
	$ 37,994,390	**$ 77,017,840**
CONTINGENCIES AND COMMITMENTS (Note 6)		
	$147,054,513	**$197,795,598**

STATEMENT OF CONSOLIDATED EARNINGS

The Southland Corporation and Subsidiaries

	Year ended December 31	
REVENUES:	**1967**	**1968**
Net sales (including franchised stores)	$527,327,025	**$621,114,512**
Interest and other income	160,865	**929,546**
	$527,487,890	**$622,044,058**
COST OF SALES AND EXPENSES (Note 10):		
Cost of sales and expenses exclusive of items listed below	$480,500,176	**$563,465,682**
General and administrative expenses	4,170,044	**5,167,486**
Property and equipment rentals (Note 6)	19,659,656	**22,046,415**
Depreciation	4,134,000	**6,297,085**
Interest expense	3,296,969	**4,063,243**
Contributions to employees' savings and profit-sharing fund	1,466,012	**1,958,350**
	$513,226,857	**$602,998,261**
EARNINGS BEFORE FEDERAL INCOME TAXES AND EXTRAORDINARY ITEM	$ 14,261,033	**$ 19,045,797**
FEDERAL INCOME TAXES	7,047,000	**9,700,000**
EARNINGS BEFORE EXTRAORDINARY ITEM	$ 7,214,033	**$ 9,345,797**
EXTRAORDINARY ITEM — Refund of federal income taxes assessed in prior year	520,000	**—**
NET EARNINGS	$ 7,734,033	**$ 9,345,797**
EARNINGS PER SHARE (Note 7):		
Before extraordinary item	$ 1.22	**$ 1.40**
Extraordinary item	.09	**—**
Net earnings	$ 1.31	**$ 1.40**
PRO FORMA EARNINGS PER SHARE (Note 7):		
Before extraordinary item	$ 1.13	**$ 1.27**
Extraordinary item	.08	**—**
Net earnings	$ 1.21	**$ 1.27**

See notes to financial statements.

STATEMENT OF CONSOLIDATED STOCKHOLDERS' EQUITY

The Southland Corporation and Subsidiaries

	Year ended December 31	
	1967	1968
COMMON STOCK:		
Balance January 1	$ 36,777	$ 57,765
Exercise of stock options	613	577
3% Stock dividend	1,120	1,976
Stock split — 3-for-2 (Note 7)	19,255	
Adjustment of 1967 stock split entry for cash paid in lieu of fractional shares		(7)
Issuance of stock upon conversion of 5% Convertible notes		836
Proceeds from public stock offering		7,500
Acquisition of Gristede Bros., Inc.		3,157
Balance December 31	$ 57,765	$ 71,804
ADDITIONAL PAID-IN CAPITAL:		
Balance January 1	$ 12,392,444	$ 16,894,723
Exercise of stock options	835,222	778,526
3% Stock dividend	3,686,312	7,782,002
Stock split — 3-for-2 (Note 7)	(19,255)	
Adjustment of 1967 stock split entry for cash paid in lieu of fractional shares		7
Issuance of stock upon conversion of 5% Convertible notes		1,699,164
Proceeds from public stock offering		17,340,564
Acquisition of Gristede Bros., Inc.		11,518,652
Balance December 31	$ 16,894,723	$ 56,013,638
EARNINGS RETAINED IN THE BUSINESS:		
Balance January 1	$ 18,346,726	$ 21,041,902
Net earnings for the year	7,734,033	9,345,797
	$ 26,080,759	$ 30,387,699
Less:		
Cash dividends	$ 1,342,085	$ 1,557,096
Cash paid in lieu of fractional shares		114,227
3% Stock dividend	3,696,772	7,783,978
	$ 5,038,857	$ 9,455,301
Balance December 31	$ 21,041,902	$ 20,932,398
TOTAL STOCKHOLDERS' EQUITY (Notes 4 and 5)	$ 37,994,390	$ 77,017,840

See notes to financial statements.

CHANGES IN NET WORKING CAPITAL 1968

The Southland Corporation and Subsidiaries

WORKING CAPITAL, DECEMBER 31, 1967		**$ 41,056,359**
Additions:		
Net earnings	$ 9,345,797	
Depreciation	6,297,085	
Deferred credits	1,984,877	
Long-term debt	1,828,929	
Exercise of stock options	779,103	
Public stock offering	17,348,064	
Working capital of Gristede at date of acquisition	6,664,563	
Other (net)	348,049	
	$ 44,596,467	
Deductions:		
Cash dividends	$ 1,557,096	
Cash paid in lieu of fractional shares	114,227	
Plant and equipment	27,352,051	
	$ 29,023,374	
		15,573,093
WORKING CAPITAL, DECEMBER 31, 1968		**$ 56,629,452**

NOTE 1 — PRINCIPLES OF CONSOLIDATION:

The financial statements include the assets, liabilities, sales, and costs and expenses of all subsidiaries. Intercompany transactions have been eliminated in consolidation.

Gristede Bros., Inc. was acquired December 16, 1968, in a transaction accounted for as a purchase. Accordingly, operations of Gristede have been included since acquisition.

NOTE 2 — INVESTMENT IN PROPERTY:

Investment in property includes land and buildings to be mortgaged under long-term obligations or to be sold to outsiders. Current working funds are used in the construction of new facilities. Periodically throughout the year, the Company sells completed facilities to outsiders for cash and/or arranges for long-term borrowings. The Company expects that cash funds will be realized within a twelve month period for these assets.

NOTE 3 — DEFERRED CREDITS:

For financial reporting purposes, investment credits relating to leased and purchased property and equipment, which are allowed as credits against federal income taxes, are taken into income ratably over the useful life of the assets or the term of the leases, respectively.

Deferred federal income taxes result from the use of accelerated depreciation methods for tax purposes.

	Investment credit	Deferred federal income taxes	Other	Total
Balance January 1, 1968	$2,463,757	$1,754,658	$314,250	$4,532,665
Balances of Gristede at acquisition	—	1,004,789	132,977	1,137,766
Provided for the year	1,067,097	1,253,863	75,160	2,396,120
Taken into income	(480,391)	—	—	(480,391)
Balance December 31, 1968	$3,050,463	$4,013,310	$522,387	$7,586,160

NOTE 4 — LONG-TERM DEBT:

At December 31, 1968, long-term debt and amounts due within one year were as follows:

	Amount outstanding	Current portion	Balance included in long-term debt
5¾% Promissory notes due 1976	$24,062,500	$3,437,500	$20,625,000
4%-7% Real estate notes	21,867,791	1,924,066	19,943,725
5% Convertible subordinated notes due 1984	9,550,000	—	9,550,000
5¾% Convertible subordinated notes due 1987	12,000,000	—	12,000,000
	$67,480,291	$5,361,566	$62,118,725

Approximately 25% of the net carrying value of property, plant and equipment is mortgaged. These real estate notes have maturity dates from 1969 to 1987.

The 5% and the 5¾% convertible subordinated notes may, at the option of the holders, be converted at any time into common stock of the Company at the rates, respectively, of 50.67 and 41.33 shares of stock for each $1,000 principal amount of notes. These rates decrease to 44.59 and 39.29 shares on January 1, 1975 and December 1, 1977, respectively. At December 31, 1968, there were 979,859 shares of common stock reserved for the conversion of notes. Principal payments are due annually beginning in 1975 and 1973, respectively, in amounts equal to 10% of the aggregate principal amount of notes outstanding one year prior to the date of the first required payment.

In view of pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants, no discount has been assigned to the convertible subordinated notes due 1987. If a discount had been assigned, the effect on net earnings would not have been material.

The aggregate amounts of long-term debt maturities for the five years following December 31, 1968, are: 1969 — $5,361,566; 1970 — $5,302,253; 1971 — $5,354,424; 1972 — $5,375,814; 1973 — $5,460,895.

The loan agreements under which the promissory notes and the convertible subordinated notes were issued place certain restrictions on the payment of cash dividends. Under the most restrictive of these provisions, retained earnings totaling $11,358,000 at December 31, 1968, were not so restricted. Other provisions of the loan agreements include requirements as to maintenance of working capital and net worth. The Company has complied with these requirements.

NOTE 5 — STOCK OPTIONS:

At December 31, 1968, options for 290,858 shares of the Company's stock, at prices ranging from $2.33 to $29.61 were outstanding, of which 195,237 shares were exercisable. During 1968, 59,283 shares were issued upon exercise of options at prices ranging from $1.88 to $29.61; options were granted for 16,275 shares at $29.61 per share; and options for 5,648 shares expired or were cancelled. In connection with the acquisition of Gristede Bros., Inc., the Company assumed outstanding restricted and qualified stock options of Gristede, whereupon options for 63,205 shares were granted at prices ranging from $21.60 to $22.67.

An additional 113,590 shares are available for future grants under the employees' stock option plan.

NOTE 6 — LEASE COMMITMENTS:

Certain of the property and equipment used in the Company's business is leased. Minimum rental payments for 1969 under lease agreements in effect as of December 31, 1968, exclusive of taxes and insurance payable by the Company, approximate $15,852,000 for real estate leases and $8,013,000 for equipment leases.

Real estate leases range generally from 15 to 20 years and equipment leases from 5 to 10 years. Future minimum annual rental payments for leases in effect at December 31, 1968, are approximately as follows for each year specified.

Year	Real Estate	Equipment	Total
1973	$12,694,000	$4,865,000	$17,559,000
1978	9,046,000	52,000	9,098,000
1983	5,703,000	—	5,703,000
1988	1,524,000	—	1,524,000
1993	533,000	—	533,000

NOTE 7 — EARNINGS PER SHARE:

On January 24, 1968, the Board of Directors approved a 3-for-2 stock split to be effected in the form of a 50% stock dividend payable February 20, 1968, to holders of record January 31, 1968.

Retroactive effect has been given to this stock split in the financial statements for 1967 and accordingly all share and per share information has been adjusted to reflect this stock split.

The earnings per share information is based on the average number of shares outstanding in each year, adjusted for stock dividends and the 3-for-2 stock split in January, 1968.

The pro forma earnings per share information is based on the assumption that the 5% and 5¾% convertible subordinated notes outstanding at December 31, 1968, had been converted into shares of common stock at the stated conversion rates at the earliest possible dates, that the related interest requirements had been eliminated and that outstanding stock options had been exercised.

NOTE 8 — SUBSEQUENT EVENTS:

On January 2, 1969, the Company acquired the Chicago dairy operations of Sidney Wanzer & Sons, Inc., in exchange for 63,700 shares of Common Stock.

The Company expects to enter into an agreement to acquire by merger the toiletries and cosmetics operations of The Nestle-LeMur Company. Consummation of the acquisition will be dependent upon the satisfaction of certain conditions including receipt of a favorable tax ruling and approval by the stockholders of the Company and of The Nestle-LeMur Company. The Company would have been required to issue a maximum of 415,748 shares of Common Stock if the merger had been consummated at December 31, 1968.

NOTE 9 — DEPRECIATION POLICY:

Provision for depreciation has been made at annual rates based upon the estimated useful lives of assets using the straight-line method. Amortization of improvements to leased properties is based upon the remaining lives of the leases or the estimated useful lives of such assets, whichever is the shorter.

NOTE 10 — CLASSIFICATION OF COST OF SALES AND EXPENSES IN ANNUAL REPORT TO THE SECURITIES AND EXCHANGE COMMISSION:

Cost of goods sold, including buying and occupancy expenses	$485,742,537
Selling, general and administrative expenses	111,234,131
Interest expense	4,063,243
Contributions to employees' savings and profit-sharing fund	1,958,350
	$602,998,261

TOUCHE, ROSS, BAILEY & SMART

DALLAS FEDERAL SAVINGS BUILDING
DALLAS, TEXAS 75201

Board of Directors and Stockholders
The Southland Corporation
Dallas, Texas

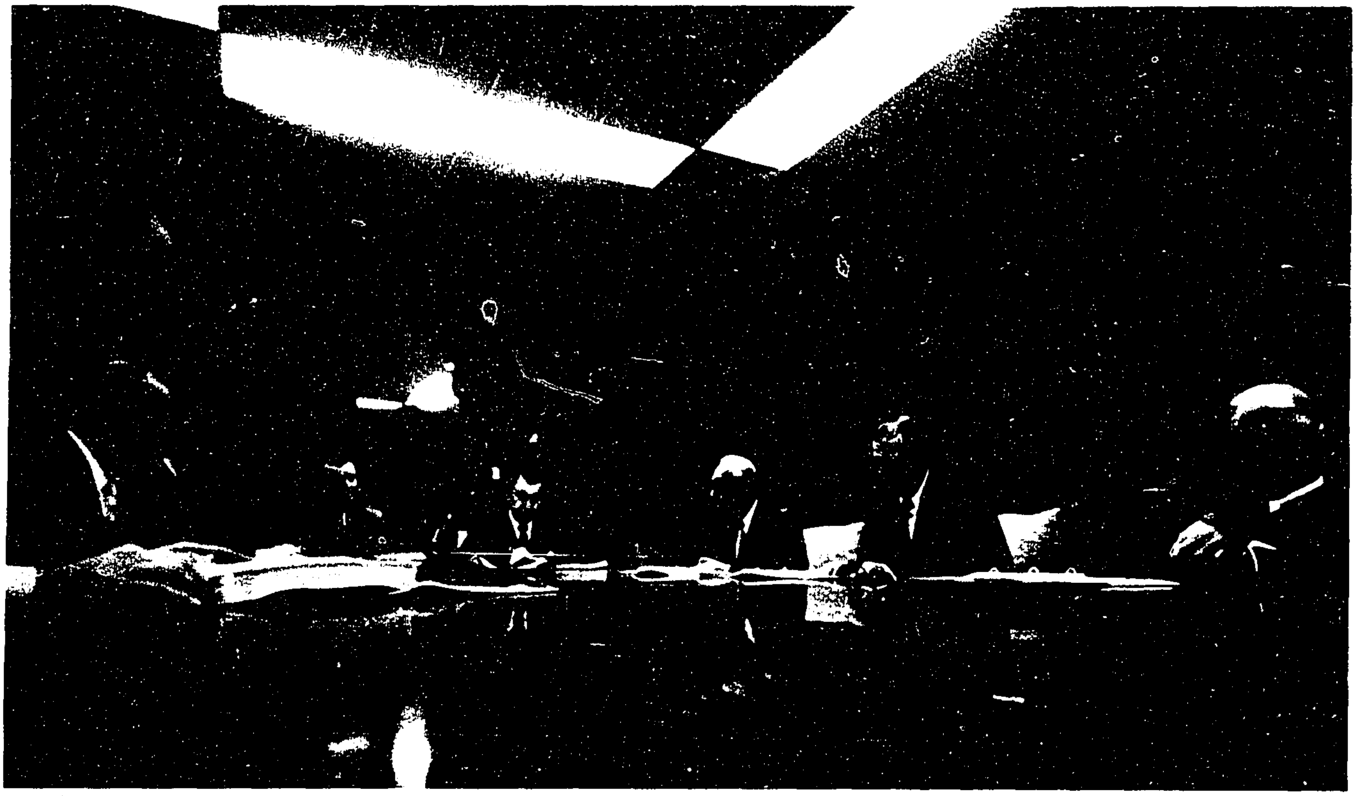
We have examined the accompanying consolidated balance sheet of The Southland Corporation and subsidiaries as of December 31, 1968, and the related statements of earnings and stockholders' equity for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements referred to above present fairly the consolidated financial position of The Southland Corporation and subsidiaries at December 31, 1968, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche, Ross, Bailey & Smart

Dallas, Texas
February 17, 1969

Certified Public Accountants



Board of Directors Left to right Jere W Thompson, J Y Ballard, Walton Grayson III, John P. Thompson, H E Hartfelder, Webster Atwell, Clifford W Wheeler, and W W Overton Jr

BOARD OF DIRECTORS

Webster Atwell	*Partner, Atwell, Grayson & Atwell*
J. Y. Ballard	*Vice President / Independent Consulting Engineer*
Walton Grayson, III	*Vice President and General Counsel / Partner, Atwell, Grayson & Atwell*
H. E. Hartfelder	*Executive Vice President*
W. W. Overton, Jr.	*Chairman of the Board and Chief Executive Officer of Texas Bank & Trust Company*
Jere W. Thompson	*Vice President*
John P. Thompson	*President*
Clifford W. Wheeler	*Vice President*

OFFICERS

John P. Thompson	*President*
H. E. Hartfelder	*Executive Vice President*
Jere W. Thompson	*Vice President, Store Operations*
M. T. Cochran, Jr.	*Vice President, Dairy Operations*
Clifford W. Wheeler	*Vice President, New Areas*
Walton Grayson, III	*Vice President and General Counsel*
Joseph S. Hardin	*Vice President, Planning and Development**
J. Y. Ballard	*Vice President*
W. K. Ruppenkamp	*Treasurer*
J. B. Langford	*Secretary*
R. G. Smith	*Controller*

**Effective March 1, 1969*

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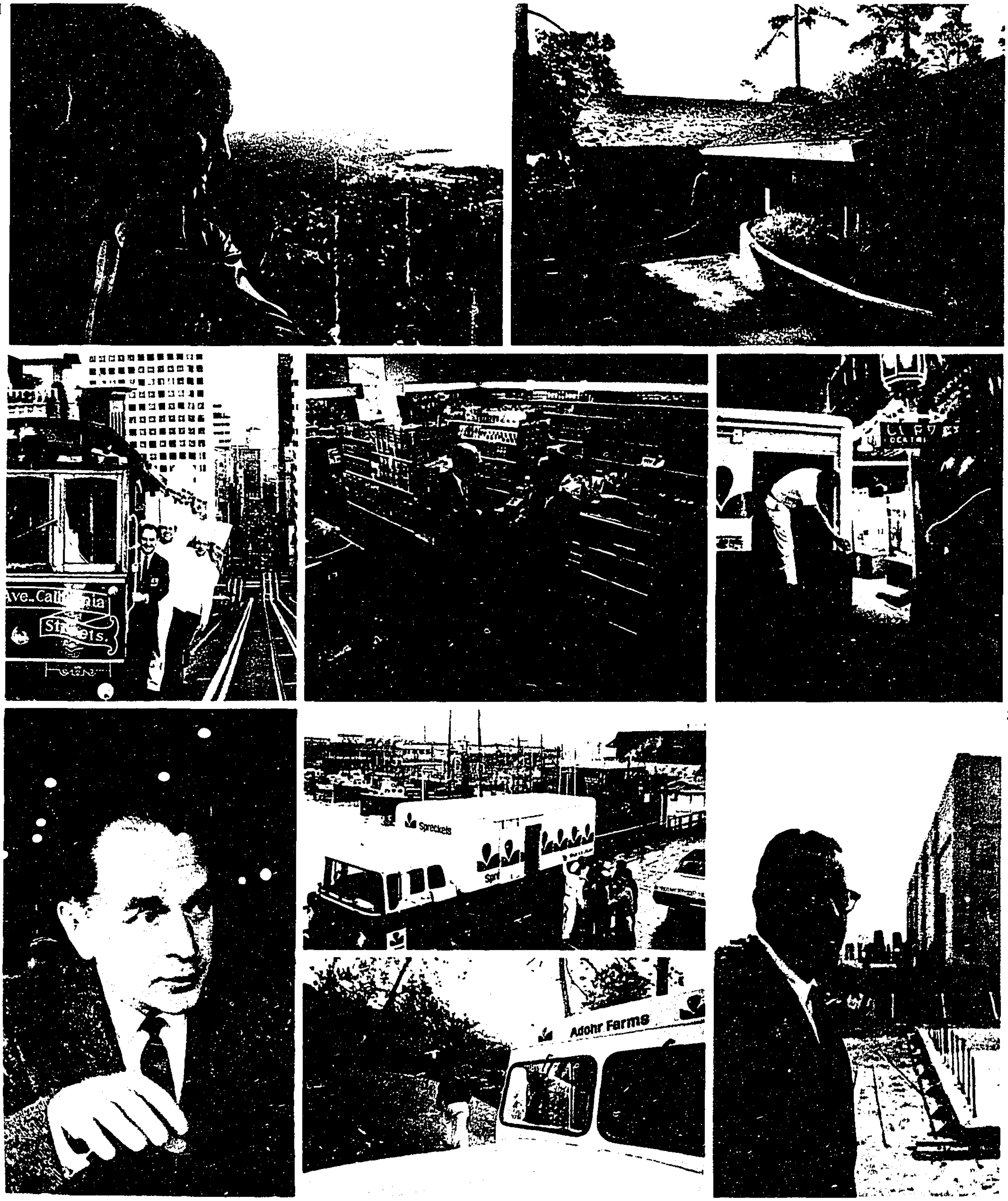
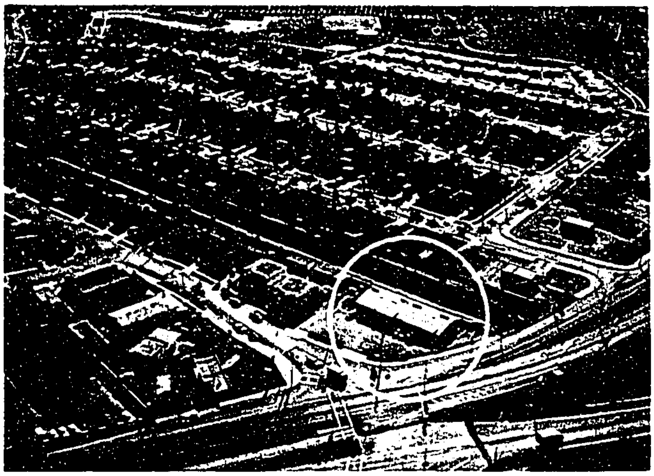


Fascinating, booming, growing West Coast U. S. A. . . . home grounds for Southland's Western Stores Division . . . and two dairy divisions . . . Adohr Farms in the sprawling Southern California area . . . and Spreckels in the glistening San Francisco Bay area . . . At 1968 year end 686 franchised 7-Eleven stores in California, Washington, Oregon and Nevada . . . with tremendous potential for more . . . they are in all sorts of locations where people live and work and play . . . from bustling suburbs to elegant Pebble Beach . . . potential customers for a 7-Eleven store are mostly within a one-mile radius . . . Southland — in all divisions — employs every means available to find suitable, profitable new store locations . . . Southland's corporate real estate staff . . . plus those at divisional level . . . use experience . . . census data . . . computers . . . and helicopters as in the view at the right . . . to spot good locations for future stores.



Adohr Farms . . . Southern California area purveyor of "Beautiful Milk for Beautiful People" . . . Trim, red-jacketed driver-salesmen in sparkling trucks . . . deliver thousands of gallons of milk and other dairy products . . . early every morning . . . to householders' doorsteps . . . while others keep dairy products rolling to institutions . . . Adohr Farms builds a new, exciting processing plant . . . with capacity for over 100,000 gallons of milk daily.

White-hatted, white-jacketed executive chefs . . . from San Francisco's famed and fabled hotels . . . demand Spreckels dairy products . . . for quality . . . and so do top-notch restaurants on Fisherman's Wharf . . . and sea-going cruise ships . . . and fishermen on the waterfront . . . and even little boys in Chinatown.

1. Sam Meyer, Western Stores Division manager oversees the growth of our stores in the West and foresees continued potential for expansion in the area.

2. For more than 60 years, Spreckels has been known and respected as one of the top quality dairies in San Francisco and it continues that tradition under the watchful eye of men like Karl Schmidt, division manager, and his group of dedicated people

3. Jack House, dairies regional manager for California, inspects construction of the Adohr Farms new processing plant which will serve the growing Orange County area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2
3
LOW FAT MILK
79

Granddaddy of all 7-Eleven operations . . . Southwestern Stores Division . . . and Oak Farms and Cabell's Dairies . . . are headquartered in Dallas . . . where Southland started over 41 years ago . . . All stores were in Texas . . . ten years ago . . . except for a few in Florida and Washington, D. C. . . . Now, of the 3,076 convenience stores at year end, the Southwestern Stores Division has 548 stores of several designs . . . including a superette twice the typical 7-Eleven size . . . it's in a North Dallas exclusive shopping center and apartment complex . . . Oak Farms and Cabell's . . . and all our dairy divisions . . . successfully sought more national accounts . . . like restaurant chains . . . and hotels . . . and big-volume supermarkets . . . where housewives find large selections . . . of milk . . . and ice cream . . . and cottage cheese . . . processed in efficient . . . automated plants.

At the same time . . . 7-Eleven stores . . . and our dairies . . . cooperate with each other . . . to display . . . and promote . . . and sell the products and services . . . our customers need and want . . . Beautiful Milk for Beautiful People . . . comes from Beautiful Cows.

1. *Vaughn Heady is manager of the Southwestern Stores* Division. In 1968 he enlarged his operating staff to keep pace with the expanding Southwest, and he led his division in a major program to air condition and remodel older stores

2. Oak Farms Dairies division manager, Jack Hartfelder, and his staff worked hard to sell this major Dallas supermarket *chain on featuring Oak Farms dairy products, and in 1968* they succeeded.

3. L. B. Smith, Cabell's Dairies division manager, boosted sales and profits in 1968 to the best in its 35 year history and extensively remodeled, enlarged and modernized the McKinney, Texas, ice cream plant.

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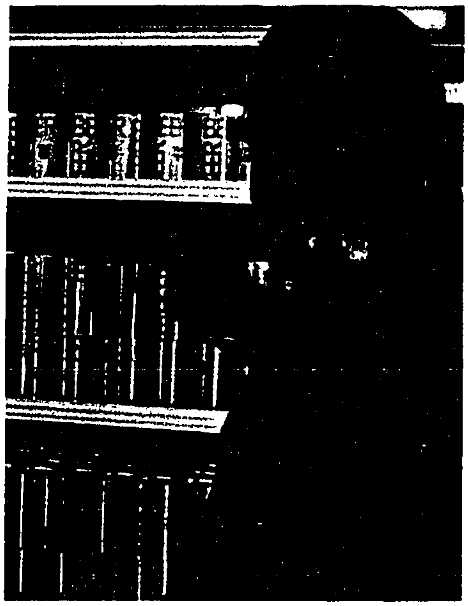

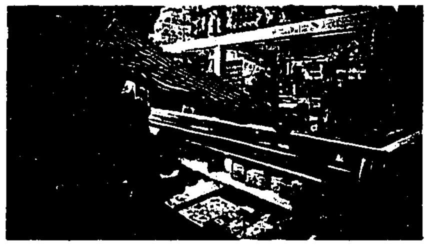

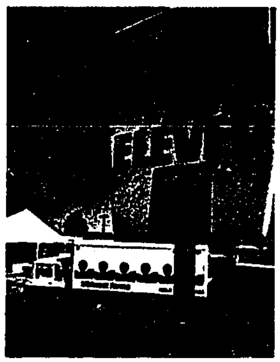

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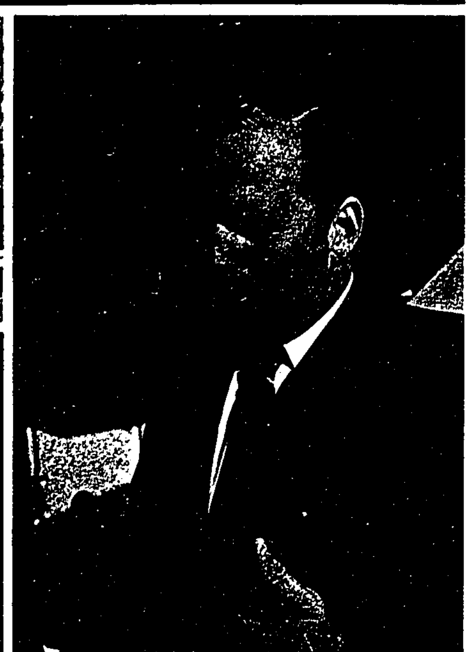

Snow and gorgeous scenery . . . and the Rocky Mountains . . . a perfect backdrop for 7-Eleven stores in the Mountain Stores Division with headquarters in Denver . . . growing lustily . . . in winter skiing time . . . and summer tourist season . . . Store personnel . .. in candy-striped jackets . . . help customers with their purchases . . . and suggest other items . . . and thus increase profits.

SLURPEE . . . semi-frozen carbonated drink . . . is popular in the Mountains . . . and in the warm South . . . and kids from 2 to 102 bought over 150 million of them last year . . . just like this youngster on the right . . . Southern Stores Division headquarters are in Atlanta . . . the changing South . . . where stately southern colonial . . . is a popular store design . . . along with contemporary . . . where teenagers gather.

Vast cool storage vaults . . . hold the day's supply of Midwest Farms milk . . . headquartered in Memphis, Tennessee. . . and in other plants in an eight-state area . . . delivered by some of the fleet of more than 3,000 trucks which Southland operates . . . and wonderful employees . . . helping Southland grow.

1. Youthful Ben Holland manager of the Mountain Stores Division smiles over progress of his division in sales and profits and growth in number of stores

2. H R Brasuell manager of the Southern Stores Division looks over a display of our 7-Eleven brand beer, which his Division and Eastern Stores Division inaugurated with success in 1968

3. World premiere of new dairy cartons was launched by Jack Gentle manager of the Midwest Farms Dairies division, with great success

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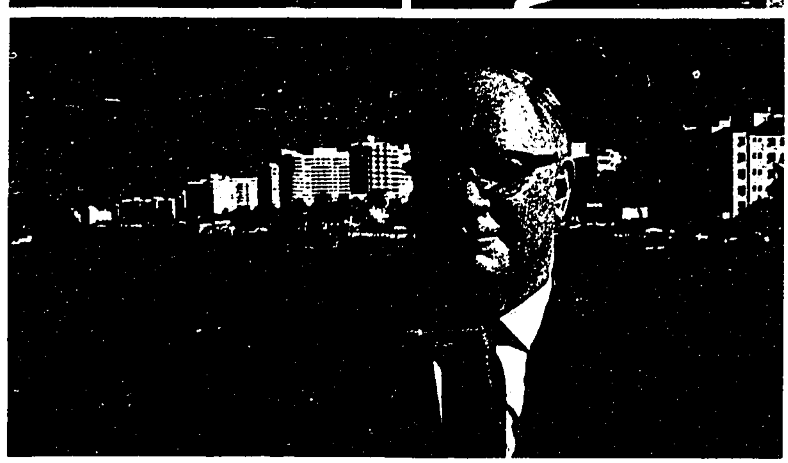

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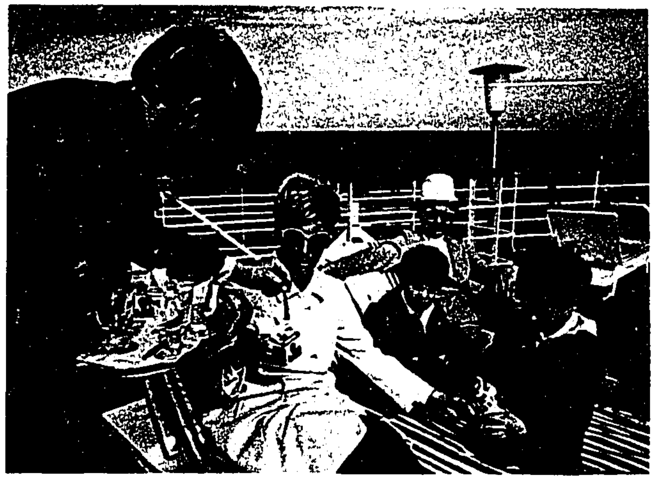
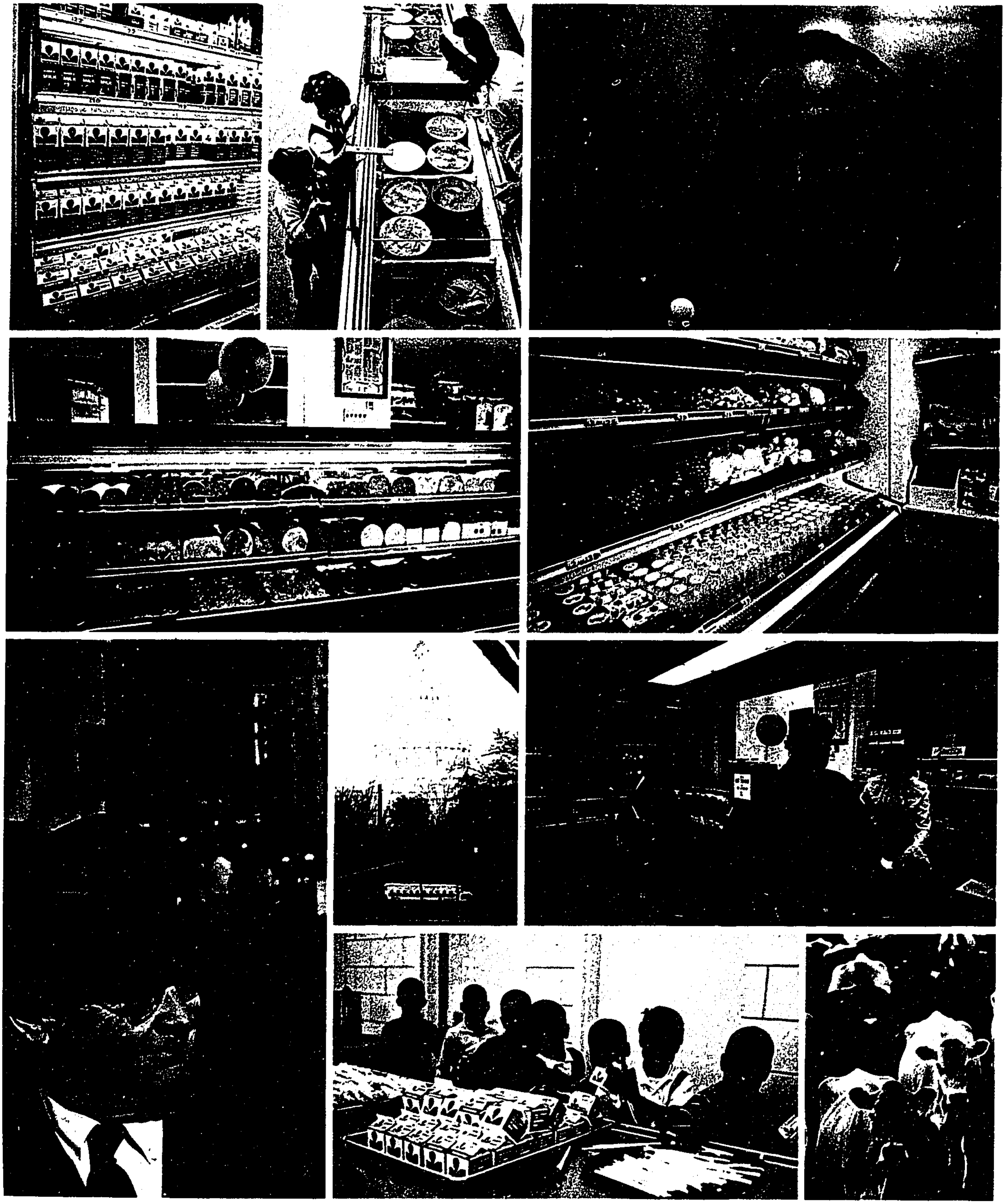
Land of the Fountain of Perpetual Youth . . . Florida . . . where the Southeastern Stores Division and Velda Farms . . . thrive and grow . . . from Key West to Tallahassee and from coast to coast . . . The first 7-Eleven store in Florida opened in 1954 . . . its 500th opened in October, 1968 . . . Florida was the scene of Southland's 3,000th store opening in 1968.



Merchandising takes many forms in 7-Eleven store operations . . . including . . . being friendlier . . . having cleaner stores . . . fresher products . . . than the competition . . . It includes decisions to market our own brands . . . such as 11 flavors of canned soft drinks . . . introduced with great success in 1968 . . . under the 7-Eleven label . . . Merchandising means promotion of SLURPEES and ICEES . . . and Beautiful Milk from Velda Farms at golf tournaments . . . on board ships cruising the warm Gulfstream waters . . . where children . . . and grown-ups, too . . . take a mid-afternoon milk break . . . Merchandising means athletic tie-ins . . . like the Velda Farms Huddle Club . . . sponsored for young fans of the Miami Dolphins pro football team . . . and other dairy divisions worked with other pro teams . . . Merchandising means salesmanship of service . . . and quality . . . to Florida's thousands of fine beachside hotels . . . and clubs.

David Neale, Southeastern Stores Division manager ...ows his 7-Eleven folks what he means about being the friendliest ...ore operator in Florida as he treats a young blondie ... a tasty ICEE

. Mason Copeland, manager of Velda Farms Dairies ...ivision, is pleased that many Miami Beach resort hotels serve ...elda's milk and ice cream which "Looks Delicious — Tastes ...eautiful" in their dining rooms and beachside cabanas



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The Nation's capital . . . and the Nation's cradle of liberty . . . and the Eastern Seaboard . . . are home grounds for Southland's Eastern Stores Division . . . Embassy Dairies in Washington and Harbisons Dairies in Philadelphia . . . Eastern 7-Eleven customers want lots of delicatessen items . . . many kinds of cold cuts . . . kosher dill pickles . . . salads . . . and attractive displays of fresh fruit and produce . . . with full displays of Embassy or Harbisons dairy products . . . Store Divisions have much lee-way to stock their stores . . . with food items and other products that suit local customers' tastes . . . Huge apartment complexes in Washington suburbs . . . like those pictured at the right behind division manager Forrest Stout . . . house thousands of customers who conveniently shop in 7-Eleven stores located in their buildings.


3

Jillions of ice cream flavors . . . made by Harbisons for Baskin-Robbins . . . make ice cream cone selection a difficult task for little ones . . . but it is no problem for smiling school kids . . . to select a half-pint of Embassy's Beautiful Milk . . . in the school lunchroom . . . Embassy sells over 25 million half-pints of milk annually for school use.

. Robert J. Harbison III, Harbisons Dairies division manager, ads his team of dairy workers toward a continuing goal of et more customers, sell more to each old customer' with utstanding success

J. Ridgely Parks, Embassy Dairies division manager, views e Washington scene and likes what he sees in terms of panding sales of milk and ice cream and other dairy products

. Forrest Stout, Eastern Stores Division manager, periments boldly with new stores in vast apartment developments here convenience is a dweller's demand

Gristede Bros., Inc.

Gristede's is a famous chain of 115 stores — operating in New York City, and suburban areas of Long Island, Westchester County and Connecticut — acquired by Southland in December, 1968. Since 1891 it has operated on the uncompromising policy that customers deserve only top quality merchandise and individual service.

Seventy-four of its stores offer services such as phone orders, home delivery and charge accounts. More than a third of its total annual sales is to long-time charge account customers — 35,000 of them. It also has 29 larger, self-service supermarket-type stores, and many of its outlets operate delicatessen departments.

Gristede's meat departments are the finest and its meat cooler always has an ample supply of U.S. Prime beef ready for demanding customers. Its produce department insists on perfection and freshness in the hundreds of fruits and vegetables stocked.

The grocery department carries thousands of standard household items, as well as many specialty products. More than 300 items are packed under the firm's own private labels — Gristede, Abbey Garden and Charles & Co.

Gourmet specialty stores operate under the name of Charles & Co. These stores offer a wide variety of

Otto P. Haass, Gristede Bros., Inc. president, is very proud of the prime beef hanging in the large cooler which also stores a variety of specialty meats, fish, poultry and other items

standard foods and many unusual items — 31 varieties of domestic honey and 55 more from 22 foreign lands; 100 varieties of cheese; 200 different coffees and teas.

Sidney Wanzer & Sons, Inc.

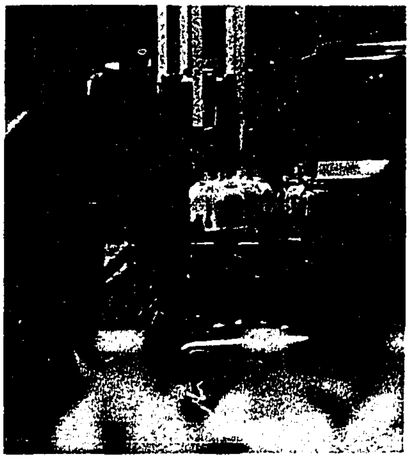
Founded in 1857, Wanzer from its very beginning insisted on quality products as a guiding philosophy. The company was the first in Chicago to pasteurize milk, and it holds Chicago Board of Health Permit No. 1 and the State of Illinois, Department of Public Health, Certificate of Approval No. 1.

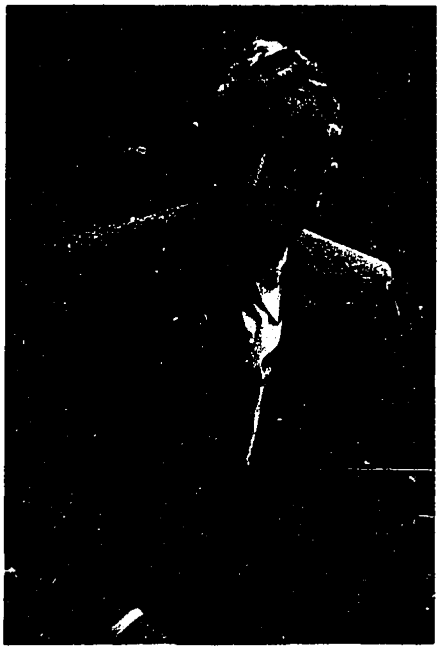
Southland acquired Wanzer in early January, 1969, and is indeed fortunate to have this fine dairy with its excellent management and personnel as the Company's representative in the huge and growing Chicago metropolitan market — a new area of the United States for Southland dairy products.

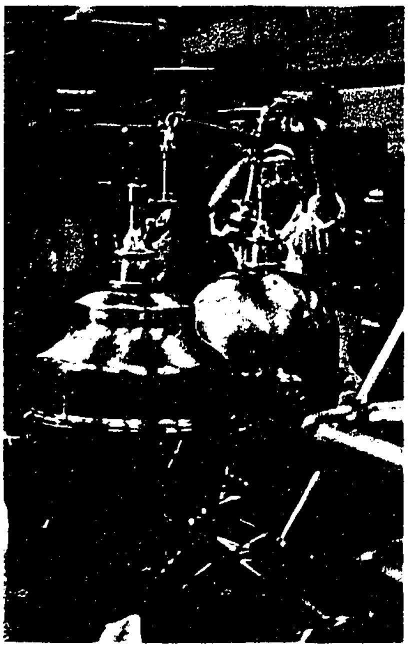
In its recently-modernized and automated plant in Chicago, Wanzer last year processed 267 million pounds of milk. Creamy cottage cheese is a particular specialty of Wanzer, along with its full line of other milk and ice cream products.

Among its wholesale customers are major hotels, airlines, hospitals, colleges and universities, many business clubs, country clubs, and a wide range of retail stores.

Henry Soldwedel president of Sidney Wanzer & Sons, Inc., will continue to guide the dairy in processing and distributing a full line of milk and ice cream products







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Corporate staff members provide all divisions of the Company with specialized services. 1. Financial staff includes W. K. Ruppenkamp, treasurer, J B Langford, corporate secretary, and R G. Smith controller. 2 Bob Stanford, advertising director, and Frank Harting, director of public relations. 3 Robert Moore, corporate director of personnel, and Robert Whitted, corporate director of real estate. 4. Alan Dodds, corporate achitect. and Obert Irvine, corporate engineer 5 Walton Grayson III, vice president and general counsel, and Clifford W. Wheeler, vice president of new areas.